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DEPARTMENT PASS TO USTR (AGAMA)
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TAGS: EFIN ECON PGOV NI
SUBJECT: NIGERIA: BANKING CONSOLIDATION SECOND WAVE

REF: A. Lagos 553

¶B. Lagos 549
¶C. Abuja 1793
¶D. Abuja 1438
¶E. Abuja 887
¶F. Lagos 32

¶1. Summary. The second wave of banking consolidation is underway with a large portion of the banking community under-banked. By the end of 2007 at least 7 banks will have share capital in excess of $1 billion and ten with over $2 billion. Banks are raising additional capital in both the domestic and international capital markets to spread operations, and resist takeovers. Banks are eyeing the lucrative management of the Government of Nigeria's (GON) large foreign exchange reserves. Increased competition and a demanding shareholder base pose challenges to improving returns to shareholders and credit risk management. Spring Bank may become the first casualty of the consolidation and may not be alone. Despite challenges, banking officials remain optimistic in this fast growing sector. End Summary.

¶2. EconOffs met with five senior bank executives to discuss the current situation, challenges, and future outlook of the banking sector since consolidation. The banks focused on were selected based on size and market share, and were Zenith Bank and Guaranty Trust Bank (GTB) (top tier banks), First Inland Bank(FIB), (a mid-level bank made up of four merged banks), Unity Bank, (a lower level bank made up of nine merged banks), and Spring Bank a merger of six banks.
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Central Bank's Views

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¶3. According to a recent assessment by Professor Charles Soludo on June 12, 2007, the ongoing banking consolidation program has been a huge success. Over $1 billion has been invested in the sector in the last twelve months, and several hundreds of million of dollars are still pouring in. Non-performing loans as a percentage of total loans before consolidation have gone down from 23% to less than 8%, total deposits have almost doubled, and credit to the private sector grew - annualized at 72% within the first four months in 2007.

¶4. Interest rates are gradually coming down and there are over 4,100 commercial bank branches, up from 3,200 prior to consolidation. The total employment in the sector is far higher than before consolidation, and Soludo expects by the end of 2007, there will be seven or more banks with shareholders funds in excess of $1 billion, and over ten banks with market capitalization over $2 billion.
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Consolidation's Second Wave

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¶5. Following the initial consolidation mandated by the CBN, a second wave of consolidation has begun, driven by market forces. A number of competing banks are discussing mergers to increase their size and market share. South Africa's Standard Bank through Stanbic Bank in Nigeria has begun acquiring a 51% stake in IBTC-Chartered Bank. Unity Bank and Eco Bank signed a memorandum of understanding, and First Inland Bank is in discussions with Eco Bank. Jacobs Moyo Ajekigbe, Managing Director of First Bank told us that merger discussions between First Bank and Eco Bank are still on contrary to rumors. Experts contend that jockeying between banks will continue as the banking sector evolves and market forces take hold. The bank officials we spoke with were clear that as long as additional shareholder wealth was created the consolidation would accelerate.
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Why Raise More Capital?

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¶6. Banks continue to shop for capital both in the domestic and international market. Banks are using the new capital for opening additional branches; deploying new technology; warding off hostile takeover, and qualifying to manage the GON's foreign reserves. Some banks are raising new capital through public and bond offerings in the domestic and international capital markets. Guaranty Trust Bank (GTB) issued a $300 million Eurobond in February which was oversubscribed by $221 million. GTB concluded a $750 million Global Depository Receipts (GDR) offering with $250 million raised locally and $500 million internationally, culminating in the listing of GTB's GDR on the London Stock Exchange. Access Bank is raising 70 billion naira ($551 million) through a public offer. Fidelity Bank is raising 49 billion naira ($386 million) through a combination of public offer and rights issue to existing shareholders; and First Bank concluded a 100 billion naira ($787 million) offer.

Foreign Incursion

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¶7. Falalu Bello, Unity Bank CEO and Okey Nwosu of First Inland Bank contended that Nigerian banks were not afraid of foreign participation and welcomed it. Most Nigerian banks are holding discussions with or already have foreign banks and foreign institutions interested in them. Foreign investments have resulted in an inflow of foreign staff into the banking sector, and Nigerian banks are sending their staff abroad to affiliated financial institutions for skills training.

¶8. First Bank's 100 billion naira ($787 million) offer prospectus stated that a large percentage would be preferentially allotted to foreign institutional investors. Industry insiders suggest that HSBC, First Bank's technical partner in the management of its foreign reserves will be allotted the shares. Access Bank's offer prospectus stated that out of the 70 billion naira ($551 million) it plans to raise, 30 billion naira ($236 million) will be preferentially allotted to foreign investors. Vectis Capital, EMP Africa Fund II, AIG Global Emerging Markets Fund II, and Rand Merchant Bank of South Africa all foreign financial institutions recently invested 20.25 billion naira ($161 million) of convertible preferred equity in Intercontinental Bank.

¶9. The International Finance Corporation (IFC) has provided a $50 million convertible loan to UBA Plc. The $50 million is part of a $75 million financing and advisory package the IFC approved. The package includes $25 million in partial credit guarantees for bonds and medium term notes that UBA plans to issue to finance mortgage lending and other strategic businesses. First City Monument Bank (FCMB) secured 10 billion naira ($78.7 million) direct equity investment by Helios Investment Partners, a United Kingdom based equity fund.

¶10. Actis, a leading private equity investor in emerging markets, recently acquired 19.1% equity in Diamond Bank at a value of 17 billion naira ($134 million). The investment will make available to Diamond Bank international corporate governance standards and processes that Actis has acquired. In 2005 the Netherlands

Financial Development Company invested $15 million and the IFC $30 million in equity in Access Bank. Standard Bank Group's acquisition of IBTC-Chartered Bank will bring in $525 million of foreign direct investment into Nigeria.

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New Credit Lines

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¶11. Nigerian banks continue to shop for credit lines in order to manage their assets and liabilities because most deposits usually have terms not exceeding 90 days and the banks have to finance transactions with longer periods. International export credit agencies and foreign financial institutions continue to increase their credit lines to Nigerian Banks. The U.S. Export-Import Bank recently increased its credit lines to Nigerian banks from $300 million to $405 million. The number of Nigerian banks that are eligible to benefit from the facility increased from 14 to 17. In 2006, the IFC provided a $15 million convertible loan to Access Bank for Access Bank/IFC Gender Entrepreneurship Program. Intercontinental Bank's credit lines are at $1 billion, and FCMB received $200 million from HSBC Holdings Plc between March and July 2007 to fund its growth plan. GTB's $350 million Eurobond will be used to finance projects in the oil and gas and telecommunication sectors.

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Nigeria's First Credit Bureau

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¶12. To improve retail banking business and increase retail lending, nine local banks in partnership with Dunn and Bradstreet established the first Nigerian credit bureau - the Credit Reference Company (CRC). The CRC will compile public record data, including statutory information, identity information, credit transactions and payment histories of individuals and organizations. The CRC will provide needed information to subscribers, including negative and positive reports on borrowers to assist financial institutions in their lending activities. The nine participating banks are UBA, First Bank, IBTC Chartered Bank, GTB, Diamond Bank, Intercontinental Bank, Standard Chartered Bank, FCMB, and Access Bank.

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Diversification and Expansion Plans

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¶13. Banks are paying serious attention to growth strategies in a bid to capture market share, and have diversified into other segments of the financial services industry. Some have diversified into insurance, pension funds, stock broking, microfinance, asset management, and investigating at diversifying into mortgages.

However, the absence of a legal framework hinders banks investing in mortgages, especially the absence of a foreclosure law. Jide Ogundare of GTB said that once better laws were passed his bank will invest heavily in mortgages.

¶14. All 25 consolidated banks are opening new branches while UBA and Eco Bank are cherry picking branches from the liquidated banks. Banks are also establishing their presence within the sub-region in Ghana, Sierra Leone, and Gambia. First Bank, Zenith Bank, and Union Bank have established subsidiaries in the U.K. GTB will open a subsidiary in London soon and has plans to establish subsidiaries in Liberia and francophone West African countries. Unity Bank will establish subsidiaries in Chad, Niger and Gambia.

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Corporate Governance

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¶15. A new corporate governance code was introduced in April 2006. The corporate governance code limits government direct and indirect equity holding in a bank to 10%, and an equity holding above 10% by an investor requires CBN approval. Other features of the code are separating the Board chairman's responsibilities from the managing director/chief executive officer; and two members of the same family cannot occupy the position of board chairman and chief executive officer or bank executive director at the same time. The code precludes the chairman of the board from serving as chairman or

member of any of the board committees. There are also penalties for rendering false returns, and all insider related credit applications pertaining to directors and top management staff and parties should be sent for approval to the Board Credit Committee. The Board Credit Committee cannot be chaired by the chairman of the board or the managing director.

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Spring Bank "Cooking the Books"

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¶16. The CBN has said that it has a zero tolerance for fraud and following the initial consolidation undertook an exercise to verify the 25 billion naira shareholder capital requirement. Spring Bank, a merger of six banks that consolidated very close to the December 31, 2005 deadline, came under scrutiny and after further investigation the CBN directed the bank to increase its capital base within six months. It has been alleged that some of the directors paid for shares only on paper without making cash payments. The CBN and Nigerian Depository Insurance Commission (NDIC) found that Spring Bank under-listed the volume of shares held by bank directors and the shares were funded directly through forgeries and manipulation of bank records. Spring Bank was unable to satisfy the requirements and only two of the merged banks, Guardian Express and ACB International were held to have brought positive capital to the merger. In response, the CBN ordered Spring Bank to replace the Managing Director and its Board of Directors. Deep divisions existed within Spring Bank and CBN had to intervene and appoint a "neutral" board. EconOff met with Dr. H. I. Mohammed, one of the CBN appointed board members, and he confirmed that the "books were cooked" with creative "econometrics" to satisfy the consolidation and that other banks may have done the same.

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Challenges Ahead

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¶17. The banks that met the recapitalization deadline without merging with other banks, such as GTB and Zenith, have moved to the next stage without having to solve integration problems. Falalu Bello of Unity Bank and Okey Nwosu of First Inland Bank said that integration problems related to technology, people, and processes persist. Bello and Nwosu said putting all the branches on a single information technology platform have been resolved while training and re-training of staff continues.

¶18. Most of the banks are listed on the Nigerian Stock Exchange resulting in pressures to improve performance and returns to shareholders, while facing increased competition, demands for higher returns, and solving integration problems. Bello said the Unity Bank Board and shareholders have agreed to wait two years before receiving dividends.

¶19. Banks now have more capital compared with what existed before consolidation and could be tempted to give out loans that could easily become delinquent thus creating additional challenges on how to manage credit risk. The CBN is tackling the problem through its risk based supervision of banks and sponsoring training on credit risk management for banking staff at the Financial Institutions training Center in Lagos. Most banks understand that their workforce does not have the necessary skills and the training of staff is a high priority. During the interim, banks are employing experienced expatriates to fill the most senior level positions.

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Comment

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¶20. Despite challenges, the senior executives we spoke with were optimistic and believed the opportunities outweighed the challenges. They were in agreement that Nigeria is under-banked and needs the banking sector to expand to the rural and semi-urban parts of the country. There are also huge opportunities in retail banking and with the recent establishment of the CRC, banks will be able to get credit information on customers easily and will be encouraged to lend more. There are also opportunities in consumer finance and other segments of the financial services industry.

¶21. Nigeria's banking industry is one of the fastest growing in the world and the GON plans to make Nigeria the financial hub of the African continent by 2020. The CBN will need to be vigilant regarding regulatory issues to nip problems before they become systemic. Training must be continuous and the industry should strive to attract competent staff from around the world until local capacity fills the gap and the industry knowledge base expands.

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